Statement of
H. Edwin Overcast
Vice President-Strategic Planning and Rates
AGL Resources Inc.

before the
Committee on Commerce
Subcommittee on Energy and Power

April 14, 1997

Electric Utility Industry Restructuring

About two weeks ago the Georgia General Assembly passed Senate Bill 215. That legislation essentially accomplishes two objectives. First, where regulation of monopoly services will continue, regulation is reformed to more closely mirror competitive environment. Second, where markets are or can be made competitive, markets are deregulated. This bill is the first state legislation to change completely the fundamental public policy structure applicable to the natural gas distribution industry. The legislation creates a competitive natural gas market and ultimately permits all consumers (residential, small business and large industry) to choose their natural gas supplier. We believe that there will be two significant benefits from this legislation -- greater customer choice in gas service and lower prices.

We feel strongly that this legislation will benefit all consumers because it was developed to reflect the particular circumstances of gas service at the local distribution level. Retail customers will be served by marketers, who will compete to arrange the purchase and transportation of their natural gas. The local gas company will continue to operate the pipes through which the natural gas flows. The Georgia Public Service Commission would continue to regulate services of the "pipes company" to ensure safety and reliability. Significantly, the legislation creates a competitive framework that will cause gas marketers to actively seek to serve residential and small business customers. By successfully marketing to the small consumers, gas marketers will gain access to the assets needed to serve the largest industrial customers on our system. This will guard against the practice of marketers "cherry-picking" or "cream-skimming" the most profitable customers, leaving small residential customers unserved or with higher rates. I should point out that this legislation was the collaborative product of business and environmental groups, consumers, utilities, marketers, regulators and legislators -- all working together to develop a new model for natural gas service.

Time does not permit me to describe in detail all of the provisions of this bill. Nevertheless, some features are quite unique and are necessary to ensure that competition is effective. For example, capacity on the system to serve customers on the coldest day of the year is assigned to customers so that if a customer changes to a new service provider, the capacity to deliver gas service moves with the customer. Technically, this makes the market fully contestable. Second, the "obligation to serve" becomes an "obligation to deliver" for the pipes company and an obligation to sell gas commodity is imposed on any marketer who receives a certificate from the Public Service Commission to sell gas to residential and small business customers. Third, there is a means to compensate marketers for this sales obligation through the creation of a Universal Service Fund. Fourth, the bill provides for a variety of consumer safeguards to protect service reliability and to permit re-regulation of the distribution company if market forces do not constrain prices to competitive levels. This legislation reflects a careful balance between mandates that are required to ensure that consumers realize the benefits of increased choices and decreased prices on one hand, and discretion to address the constantly changing energy marketplace.

I believe that there are a number of important lessons to be learned from this process:

1. **A federal mandate for unbundling and customer choice is not required for either natural gas or electricity.** State governments have the power, and market forces can create the incentive, to provide for customer benefits on a state-by-state basis.

2. **Federally mandated programs are not always superior solutions.** There are issues in both the natural gas and electric industry where federal legislation and regulation has adversely affected both the economy and efficiency of the energy business. As examples, consider how PURPA Sections 201 and 210 have increased electric rates for consumers in many states with relatively few benefits. Similarly, the Public Utility Holding Company Act (PUCHA) may prohibit consumers from capturing maximum benefits in the provision of energy services.

3. **There are some policy issues that transcend the bounds of state interest and should be resolved by specific federal action.** Consider, for example, how the mix of investor and publicly owned utilities creates complex issues for regulators who want to assure fair competition in energy services. All utilities in a state, whether investor owned, municipal or cooperative should be treated equally with regard to access to consumers, investment capital and competition. Perhaps the change in circumstances over the last 50 years would suggest that we should reconsider whether TVA, BPA, electric cooperatives and power marketing agencies, as presently constituted, are appropriate.

As a matter of public policy electric and gas utilities should be allowed to recover all prudently incurred costs including those costs that become stranded as a result of opening markets to consumer choice. This is another example of an issue the resolution of which should not vary from state to state. First, there is significant potential for harm to utilities and investors. Second, such uncertainty would likely further delay implementation of customer choice at the state level where these stranded costs are significant.

4. **States will respond to ensure that the benefits of competition are available to their citizens.** The benefits of consumer choice, including more service options and lower prices, are clear. As the current trend within the states continues, such benefits will be even more obvious. States will have a natural self-interest to respond in an appropriate fashion and at the appropriate time to create opportunities for their citizens.

5. **Appropriate transition from regulation to competition is essential.** Perhaps the most critical element in the Georgia legislation was the creation of an orderly transition from regulation to competition. Without a carefully managed transition, some groups of consumers may benefit at the expense of others. Further, the transition must be managed to assure that competition is effective in all markets and for all segments. This transition may vary not only by state but by regions within a state.

The importance of transition issues suggests that rushing into restructuring by means of a legislative date certain may not provide for adequate consideration of local issues. In fact, there are more appropriate ways to provide utilities incentives to be proactive in finding local solutions for transitioning from regulation to competition. For example, a federal legislative prohibition against a utility or its affiliate competing to sell natural gas or electricity in a competitive market without also having opened its own market to competition would likely focus the utility on finding ways to open its own markets.

Providing both the carrot (stranded cost recovery mandate) and the stick (prohibition against unregulated competition by an affiliate of a company that has not opened its own system) will give the utilities incentives to work with their state regulators and consumers to restructure the electric industry in ways that convey the largest benefit to the public.

Summary of Key Points
in the
Statement of
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Electric Utility Industry Restructuring

A. Competitive energy markets will benefit all consumers in two ways -- more choices and lower prices.

B. Substitute S.B.215: The Natural Gas Competition and Deregulation Act was developed to reflect the particular circumstances of gas service at the local distribution level.

C. There are five important lessons to be learned from the process that ultimately produced this legislation.

1. A federal mandate for unbundling and customer choice is not required for either natural gas or electricity.

2. Federally mandated programs are not always superior solutions.

3. There are some policy issues that transcend the bounds of state interest and should be resolved by specific federal action.

4. States will respond to ensure the benefits of competition are available to their citizens.

5. Appropriate transition from regulation to competition is essential.

D. Providing a carrot (stranded cost recovery mandate) and a stick (prohibition against unregulated competition by an affiliate of a company that has not opened its own system) will give utilities incentives to restructure the electric industry in ways that convey the largest benefit to the public.

Substitute to S.B. 215
The Natural Gas Competition and Deregulation Act

Overview

Senate Bill 215 sets up a new regulatory framework that enables all customers, large and small, to benefit from a competitive natural gas market, including more choices and lower prices.

These customers would be served by marketers, who would compete to arrange the purchase and transportation of their natural gas. The gas company would continue to operate the pipes through which the natural gas flows, and that service would continue to be regulated by the Georgia Public Service Commission (PSC) to ensure safety and reliability. Regulation of that service, however, would be reformed so that the company is rewarded for efficient operation or penalized for inefficient operation.

The marketers would compete to serve customers, residences and small businesses - in order to have access to the pipes to serve the more profitable large industrial and large commercial market. This will guard against the practice of marketers "cherry-picking" or "cream-skimming" the most profitable customers, leaving the small customers unserved or with higher rates.

This bill represents the combined efforts of many different parties, representing many different views. Consequently, this bill strikes an appropriate balance between competition and regulation. Moreover, this bill provides a framework in which competition can thrive in an open market place, while assuring that consumer protections are in place.

Key Points

Page 1 **-** contains the title of the legislation.

Section 1, Page 2 - provides the definition of "Gas Company".

Section 2, Page 2 - amends Article 2 of Chapter 2 of Title 46 by adding a new code section 46-2-23.1 which does the following:

- Although the bill talks about deregulation, everyone acknowledges that there are substantial portions of the gas distribution business that will continue to be regulated for the foreseeable future. This new section provides for an "alterative form of regulation" using performance-based regulation.

- Performance-based regulation rewards superior performance with better that average returns, and penalizes poor performance with poorer than average returns.

- Performance-based regulation is initiated by filing a rate case.

- This legislation does not invalidate the existing negotiated contracts between the gas company and its individual customers.

- In addition to the general performance-based regulation provided for in this section, special provisions have been made for capacity release and off-system sales. These provisions are designed to create incentives to maximize benefits for consumers in Georgia.

Section 3, Page 6 - amends Article 3 of Chapter 2 of Title 46 by extending to intervenors and gas companies the same discovery rights as are currently afforded to the commission staff and the Consumers' Utility Counsel in gas company rate cases.

Section 4, Page 7

Section 4 further amends Chapter 4 of Title 46 by adding a new Article 5 as follows:

46-4-150 - Page 7

This section provides the short title which is "The Natural Gas Competition and Deregulation Act."

46-4-151 - Page 7

This code section sets forth the General Assembly's findings and the intent of this article.

46-4-152 - Page 8

This section provides definitions.

46-4-153 - Page 10

This section provides that marketers who will be selling gas to firm markets (residential and small business customers) must first obtain a certificate of authority from the PSC for the geographic area that they chose to serve.

The commission may grant multiple certificates for the same geographic area, and a marketer can chose to apply for any one or more geographic areas, or for the entire state.

- Marketers must demonstrate that they have financial and technical capability, sufficient gas supply, and that they will provide service pursuant to the rules and contract terms approved by the commission.

- A marketer may use the firm capacity they have contracted for to provide interruptible sales or transportation service whenever the full amount of firm capacity is not required to meet small business and residential customer needs.

- This section provides for a process by which a number of marketers can start selling to the general public at the same time.

- An application for a certificate of authority may be denied by the commission for good cause. After a certificate has been granted, it may be withdrawn from a marketer by the commission if the marketer fails to meet its obligation to customers or if it fails to provide service pursuant to the established rules.

46-4-154 - Page 12

This section provides for the basic process by which a gas company unbundles the service it provides. "Unbundling" refers to offering each element of natural gas service individually, at a separate price.

- In the event that establishing straight fixed variable rates for firm delivery service adversely impacts any group of customers, then the commission has the authority to mitigate such impact over a 12 or 24 month period.

- During the transition, a gas company is provided with a 10 percent incentive on interruptible services, in order to maximize the contribution of interruptible revenue for the benefit of residential and small business customers.

- This section provides for unbundling service on an equal access, non-discriminatory basis.

- The electing distribution company will also set forth the manner in which it will allocate both the intrastate capacity on its system as well as rights to interstate transportation and out-of-state storage capacity.

- The electing distribution company will also establish an electronic bulletin board through which the marketers can facilitate the secondary interruptible market.

46-4-155 - Page 15

This section provides the scope of Public Service Commission regulation both during the transition period, as well as when the competitive model is fully in place.

- Firm distribution service rates will remain subject to the Public Service Commission's jurisdiction. LNG, or liquefied natural gas, will be fully regulated initially, will go through a transition to competition by using a price cap, and will become fully deregulated only after competitive alternatives have been proven to exist.

- Customer services will be offered at regulated rates until such time competitive alternatives have developed.

- During the transition, the electing distribution company will provide service at regulated rates directly to consumers, in addition to the services it will provide to marketers.

- Section (e) of this provision (pages 17-21) provides for a capacity supply plan to replace the existing gas supply plan statute for an electing distribution company.

46-4-156 - Page 21-24

Since it is unlikely that all customers will select a marketer to provide their natural gas service, this bill provides for a method of assigning customers to marketers, similar to the process which was used for telephone long distance customer assignment.

- Depending on when the assignment of customers is made, the PSC will make such assignment based on consideration of total market penetration by marketers, or upon specific market conditions.

- All consumers must receive notice that if they do not voluntarily select a marketer, they will be assigned to a marketer at random.

- If it can be demonstrated that a competitive market place will not result following customer assignment, the commission may stop the customer assignment process.

- Upon application of the electing distribution company, the commission may extend any deadline or time period imposed by this legislation in order to ensure the development of effective competition.

46-4-157 - Page 24-25

After all consumers have been assigned to marketers or have voluntarily selected their own marketer, if the PSC determines that competitive conditions no longer exist, the PSC may re-regulate the electing distribution company until the General Assembly has had time to reconvene and address the issue in a regular session.

46-6-158 - Page 25-26

This section addresses the manner in which an electing distribution company will provide firm delivery services to marketers in the competitive market place.

- All marketers will receive an allocation of distribution services based on the share of the market they serve. Distribution services will be provided to marketers without undue discrimination or preference.

- An electronic bulletin board will facilitate the operation of the system.

- Operation of the pipes distribution system will continue to be the obligation of the electing distribution company.

46-4-159 - Page 26-30
This section provides marketer standards.

- All marketers must be treated the same without regard to their affiliation with the electing distribution company.

- Specific rules of conduct are established to ensure that the benefits of a competitive market are available to consumers in Georgia.

46-4-160 - Page 30
This section provides for ongoing PSC regulation of marketers who sell services to residential and small business consumers.

- The PSC is authorized to regulate terms and conditions of service, other than price.

- The marketers have an ongoing obligation to serve the public.

- The processes of hearings and discovery, as well as consumer protection laws continue to apply.

46-4-161 - Page 31-34
This section establishes a universal service fund to compensate marketers for the obligation to serve imposed by this bill, and to allow the electing distribution company to expand its facilities in the public interest.

46-4-162 - Page 34
This section contemplates that an investor-owned gas company may wish to conduct a pilot program as a way of moving toward competition. This section allows the PSC to authorize pilot programs.

46-4-163 - Page 34
Nothing in this bill invalidates existing contracts between a gas utility and its customers.

46-4-164 - Page 34
This bill does not affect the operations of gas systems owned by any governmental authority.

46-4-165 - Page 34
The PSC is to report to the General Assembly on the status of the transition to competitive markets until the year 2002.

Outline of Substitute S.B. 215:
The Natural Gas
Competition and Deregulation Act

I. Opens access and unbundles gas services on the local gas company's system, creating a secondary market for interruptible deliver capacity

A. Open Access

1. Firm delivery (FD) capacity to meet the needs of small business and residential customers will be provided at rates set by the PSC by the "pipes" business
2. Marketers certificated by the PSC can resell unused FD capacity as interruptible deliver (ID) in secondary markets to large industrial customers when the full amount of FD is not required to meet the needs of residential and small business customers.
3. The "pipes" business offers unbundled services to marketers certificated by the PSC on a non-discriminatory basis

B. Service Unbundling

1. Firm delivery of natural gas
2. Commodity sales service to firm customers
3. Peaking service (supplements pipeline supply on coldest days)
4. Customer services
   a. Meter reading
   b. Billing
   c. Customer turn-on and turn-off
   d. Other consumer services
5. Commodity sales service to interruptible customers
6. Balancing services (matches the amount actually used with the amount ordered for use)
7. Interruptible delivery of natural gas

II. Transforms the local gas company into a "pipes" business (delivering gas but not selling gas commodity) by filing notice to become an "electing distribution company"

A. Gas company ultimately will stop selling gas commodity

B. Gas commodity will be sold by marketers in a competitive market

C. A transition from current business to "pipes" business will occur as follows:

1. Gas commodity sales by the "pipes" business to small business and residential customers will be price deregulated when multiple

marketers have been certificated by the PSC to serve an area of Georgia

2. When at least 1/3 of the total firm retail customers (based on peak day volumes) have selected marketers, the remaining customers in an area will be randomly assigned to marketers
3. "Pipes" business will continue to contract for interstate transportation and storage assets required to maintain reliable firm service to residential and small business customers
4. "Pipes" business will assign such assets to certificated marketers according to each marketer's share of the firm market

III. Requires certification by the PSC for marketers before they sell gas to small business and residential customers

A. PSC will certificate marketers to sell gas in the firm market (residential and small business customers)

B. Scope of PSC regulation includes a series of issues

1. Financial and technical capability to render service
2. Gas supply reliability criteria
3. Basic contract terms of service requirements
4. Obligations to serve the public in certificated areas
5. Services subject to the Fair Business Practices Act
6. Revocation of certificates for failure to meet contract service obligations
7. No price regulation of these certificated marketers

IV. Ensures an orderly transition from regulation to competition

A. Firm delivery rates continue to be regulated by the PSC as a monopoly service

B. Commodity sales service is competitive by area when 5 nonaffiliated marketers are certificated by the PSC

C. Interruptible delivery rates are competitive by area when all firm customers are assigned to marketers pursuant to PSC regulations

D. Peaking services are regulated initially; regulation phased out with a price cap as competitive options develop; fully price deregulated when PSC determines the service to be competitive

E. Customer services are competitive by individual service when the PSC determines that there are commercially available alternatives

F. Standards are established to determine whether services are competitive

G. A transition mechanism is developed for each area (based on pipeline delivery groups) of the Company as competition for sales service develops

V. Continues regulation by the PSC of safety, access and firm delivery rates pursuant to an alternative form of regulation

A. PSC will continue to regulate access to the “pipes” system and cost effective system expansions to promote economic development

B. PSC will continue to regulate safety of the entire “pipes” system

C. PSC will continue to regulate firm delivery service including FD rates pursuant to an alternative for of regulation

D. Appropriate rate design (SFV) is mandated to ensure maximum benefits of model to residential and small business customers

E. PSC will determine stranded costs that can be recovered to the extent such costs cannot be mitigated.

VI. Expands jurisdiction and power of PSC to enforce fair marketing rules

A. General rule of “enforced indifference” in the provision of delivery service such that all marketers, including affiliated marketers, are treated the same

B. Regulated services are provided with the same quality and price for all marketers

C. Information is communicated without providing a preference to any marketer

VII. Ensures consumer safeguards and protections

A. Creates a Universal Service Fund

1. To assure that gas is available for sale to firm customers
2. To promote expansion of distribution facilities in the public interest

B. Provides for continued regulation where competition does not exist

C. Provides for re-regulation if the PSC determines that competition is not effective in restraining prices to firm customers

D. Permits PSC to impose rules and contract terms on marketers

Professional Experience and Educational Background
of
Dr. H. Edwin Overcast

Dr. Overcast is Vice President - Strategic Planning and Rates for AGL Resources Inc. AGL Resources Inc. (AGL) is the parent company of Atlanta Gas Light Company and its wholly owned subsidiary Chattanooga Gas Company. Since he joined the Company in 1989, he has held various positions in the rate and planning area. His principal responsibilities include strategic planning for the various business units of the holding company and representing the regulated business units before regulatory and legislative bodies in matters of tariff design and regulatory practice.

His utility experience includes positions with the Tennessee Valley Authority and Northeast Utilities (NU). He has testified on behalf of the operating subsidiaries of NU in proceedings relating to rates, regulatory policy and other matters in both gas and electric proceedings. Dr. Overcast has previously testified in rate cases and other proceedings before the Connecticut Department of Public Utility Control, the Massachusetts Department of Public Utilities, the Georgia Public Service Commission, the Tennessee Public Service Commission, the Tennessee Regulatory Authority and the Federal Energy Regulatory Commission.

Dr. Overcast has been a member of several national associations including: Edison Electric Institute (E.E.I.), American Gas Association (A.G.A.) and the Load Research Committee of the Association of Edison Illuminating Companies. He has been an instructor on cost-of-service and federal regulatory issues for the E.E.I. Rate Fundamentals Course and the E.E.I. Advanced Rate

Course. Dr. Overcast has served as an instructor in the A.G.A. Rate Fundamentals Course and the S.G.A. Intermediate Level Rates Course.

He is currently a member of the International Association of Energy Economists, the National Association of Business Economists, and the A.G.A. Rate and Strategic Planning Committee.

Dr. Overcast graduated cum laude from King College with a Bachelor of Arts Degree in Economics. He received the Doctor of Philosophy Degree in Economics from Virginia Polytechnic Institute and State University. His principal fields of study included Economic Theory, Public Finance and Industrial Organization, with supporting fields of study in Econometrics and Statistics. Dr Overcast has served on the faculty of Elon College, East Tennessee State University, the University of Tennessee at Chattanooga and Georgia State University. He has taught courses at both the graduate and undergraduate level in Micro-economic Theory, Managerial Economics and Public Finance. In addition, he has taught courses in Mathematical Economics, Economics of Regulation and Money and Banking.